

**Additional Emphasis Is Needed to
Reduce the Burden for Tax Exempt and
Government Entities Division Customers
During Returns Processing**

September 2003

Reference Number: 2003-10-204

This report has cleared the Treasury Inspector General For Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 23, 2003

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT
ENTITIES DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Assistant Inspector General for Audit (Small Business and
Corporate Programs)

SUBJECT: Final Audit Report – Additional Emphasis Is Needed to
Reduce the Burden for Tax Exempt and Government
Entities Division Customers During Returns Processing
(Audit # 200310018)

This report presents the results of our review of the processing of Tax Exempt and Government Entities (TE/GE) Division returns. The overall objective of this review was to determine whether the TE/GE Division's Customer Account Services (CAS) function provided adequate oversight to ensure that the Small Business/Self-Employed (SB/SE) Division effectively processed TE/GE Division returns and resolved errors associated with the returns without unnecessarily burdening TE/GE Division customers. The TE/GE and SB/SE Divisions established a Service Level Agreement, which sets forth the services that would be provided by the SB/SE Division for processing the TE/GE Division returns. The SB/SE Division provides services such as depositing remittances submitted with returns, scanning returns, transcribing return information, and/or resolving errors that prevent the information from posting to the Internal Revenue Service's (IRS) computer system. The TE/GE Division's CAS function is responsible for evaluating the effectiveness of the services provided by the SB/SE Division.

In summary, the TE/GE Division's CAS function is generally providing adequate oversight over the processing of TE/GE Division returns that are successfully updated to the IRS' computer system. However, improvements could be made in the monitoring of returns that initially are not successfully updated to the IRS' computer system. These types of returns are called "unpostable" conditions. TE/GE Division CAS management can more closely monitor the inventory of over-age unpostable conditions and proactively attempt to identify methods to prevent or reduce unpostable conditions.

These improvements could reduce the burden placed on customers, as well as the costs associated with correcting these conditions.

We recommended that the Commissioner, TE/GE Division, develop specific measures to alert the CAS function of potential processing problems and implement a formal process for documenting and reporting measurement deviations. In addition, the Director, CAS, should work with the other functions in the TE/GE Division to proactively identify the causes or reasons for the high volume of unpostable conditions.

Management's Response: The Commissioner, TE/GE Division, generally agreed with our recommendations. The unpostable inventory level is currently being monitored for unmanageable conditions. In addition, the Director, CAS, TE/GE Division, will expand the sharing of the results of operational visit findings with the Directors of Employee Plans, Exempt Organizations, and Government Entities. The CAS function analysts have started to use the Generalized Unpostable Framework reports to monitor unpostable conditions and inventories. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs) at (202) 622-8500.

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Additional Emphasis Is Needed to Reduce the Burden for Tax Exempt and Government Entities Division Customers During Returns Processing

Background

The Tax Exempt and Government Entities (TE/GE) Division customer segments include the Employee Plans (EP), Exempt Organizations (EO), and Government Entities (GE) functions. Together, the TE/GE Division customer segments represent 2.4 million return filers with a total tax liability of approximately \$103 billion.¹ The Ogden Campus² of the Small Business/Self-Employed (SB/SE) Division processes all TE/GE Division returns,³ except the Annual Return/Report of Employee Benefit Plan (Form 5500) series,⁴ which is processed by a contractor for the Department of Labor (DOL). TE/GE Division returns are routed through several returns processing functions at the Ogden Campus so that data from the returns can be successfully input into the Internal Revenue Service's (IRS) computer systems.

Upon receipt at the Ogden Submission Processing Site, the TE/GE Division returns are extracted from envelopes, hand sorted, and organized into batches based on the type of return filed. The batched returns are then numbered for control purposes and prepared for transcription. The batches of TE/GE Division returns are processed by the same units that process SB/SE Division returns and are generally worked on a First-In First-Out basis, so the TE/GE Division returns are given the same priority as the SB/SE Division returns. The Ogden Campus uses a tracking system to monitor batches of returns as they proceed through the different processing functions.

When Form 5500 return information from the DOL contractor is not successful in reconciling with the

¹ TE/GE Division customers are tax-exempt, but many are required to file an annual information return, which is not subject to income tax. Some customers are still liable for excise and payroll taxes.

² Campuses are the data processing arm of the Internal Revenue Service. The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

³ See Appendix IV for a list of the TE/GE Division returns processed at the Ogden Campus.

⁴ Form 5500 series includes: Form 5500, Return/Report of Employee Benefit Plan (Form 5500 C/R), and Annual Return of One-Participant Pension Benefit Plan (Form 5500 EZ).

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Employee Plans Master File (EPMF),⁵ it results in an “unpostable” condition.⁶ The unpostable return information (but not the actual return) is sent to the Ogden Campus for resolution. The Ogden Campus conducts manual research to correct the return information and ensure the IRS has a complete and accurate record of the Form 5500 filing.

The TE/GE and SB/SE Divisions established a Service Level Agreement (SLA), which sets forth the services that would be provided by the SB/SE Division for processing the TE/GE Division returns. Depending on the type of return, the SB/SE Division provides all the services necessary to process the TE/GE Division return information. These services may include depositing remittances submitted with returns, scanning returns, transcribing return information, and resolving errors that prevent the information from posting to the IRS’ computer system.

The TE/GE Division’s Customer Account Services (CAS) function is responsible for evaluating the effectiveness of services provided by the SB/SE Division. To evaluate this service, the TE/GE Division’s CAS analysts monitor the activities of the processing operation and work with the processing units to resolve problems and/or improve processes.

The audit was performed at the TE/GE Division’s CAS office and the SB/SE Division office in Ogden, Utah, between April and July 2003. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁵ The IRS computer file that contains data relative to all filed Form 5500 series returns and their related attachments.

⁶ An unpostable condition occurs when a return or transaction attempted to update the IRS’ computer system but could not because of inconsistencies with prior posted transactions, filing requirements, or the input data.

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Improvements in the Monitoring of Unpostable Conditions Could Reduce Customer Burden and Costs Associated With Resolving the Conditions

The TE/GE Division's CAS function is generally providing adequate oversight over the processing of TE/GE Division returns that are successfully updated on the IRS' computer system. However, improvements could be made in the monitoring of returns that initially are not successfully updated to the IRS' computer system, resulting in unpostable conditions. TE/GE Division CAS management can more closely monitor the inventory of over-age unpostable conditions and proactively attempt to identify methods to prevent or reduce unpostable conditions. These improvements could reduce the burden placed on customers, as well as the costs associated with correcting these conditions.

The TE/GE Division implemented an organizational structure to monitor the SB/SE Division's returns processing operation at the Ogden Campus. There are nine TE/GE Division CAS analysts responsible for monitoring the processing of TE/GE Division returns. Each analyst has defined areas of responsibility and is backed up by another TE/GE Division CAS analyst. TE/GE Division CAS management uses the measures traditionally established for IRS returns processing operations to assess the effectiveness of the SB/SE Division's operation at the Ogden Campus for the TE/GE Division returns.

The TE/GE Division CAS analysts monitor and track the returns processed by reviewing daily production reports and other management information reports, and by maintaining effective working relationships with SB/SE Division managers and employees at the Ogden Campus. During this process, TE/GE Division CAS analysts look for irregularities, increases in inventories of the processing functions, and high volumes of unpostable cases. For example, TE/GE Division CAS analysts identified a processing delay associated with some Returns of Private Foundation (Form 990-PF) by monitoring a report designed to identify refund returns that are at risk of not completing processing within the Program Completion Date (PCD).⁷

⁷ The PCD is the deadline for processing returns and mailing refunds to taxpayers. Because the IRS must pay interest on any refunds not

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To successfully meet the PCD, the SB/SE Division must complete the processing of all processable returns by a specified date. Processable returns are those that do not have missing information and are ready to attempt posting to the IRS' computer system. The PCD measure applies to both current year returns filed prior to the due date and prior year delinquent returns.

During the period January through May 2003, management information reports showed that the IRS paid interest to customers totaling more than \$279,000 on Form 990-PF refund returns. Reasons for the processing delays include:

- Refund returns were incorrectly batched as non-refund returns because the batching unit did not appropriately identify them as refund returns.
- The guidelines changed from a 6-day batching schedule to an 11-day schedule.

Upon identifying the problem, TE/GE Division CAS analysts promptly brought the issue to the attention of SB/SE Division management, who initiated actions to correct the condition.

In addition to frequent monitoring of inventory levels, the TE/GE Division CAS analysts also perform assistance reviews of potential problems with the processing of TE/GE Division returns. For example, TE/GE Division CAS analysts reviewed:

- The resolution of the Notification of Proposed Penalty for Late/Incomplete Return (Computer Paragraph (CP) 213) notices to determine whether the notices were appropriately generated.
- The posting processing of Exempt Organization Business Income Tax Returns (Form 990-T) to determine whether the claims process could be streamlined by adjusting claim tolerances.
- The timeliness of processing of tax-exempt bonds.

meeting the PCD, it is the primary measure of timely processing for the IRS.

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TE/GE Division CAS management developed operating procedures for conducting these reviews, which outline the guidelines and protocol that the analysts should follow when preparing for, performing, and documenting visits within the Ogden Campus.

TE/GE Division CAS analysts provide statistical information on the processing of returns to the Director, CAS, TE/GE Division, which is ultimately shared with the TE/GE Division Commissioner and Directors through monthly operational reviews that address the EP, EO, and Tax-Exempt Bond returns. As part of these reviews, TE/GE Division CAS analysts report on processing problems and provide a status of assistance reviews being conducted.

To strengthen the oversight provided for the returns processing operations, TE/GE Division CAS management should address the following areas:

- More closely monitoring the inventory levels of returns that do not post to the IRS' computer system (i.e., the unpostable inventory).
- Working proactively with the three TE/GE Division functions (EP, EO, and GE) to reduce the number of unpostable conditions that increase the burden on customers.

Over-age unpostable inventory levels need to be more closely monitored

In many instances, the resolution of unpostable conditions requires the IRS to contact the customer through correspondence. For example, one common reason for an EO return to create an unpostable condition happens when the IRS records show that an EO customer filed a return on the incorrect form. However, if the information can not be determined by using internal research data to resolve the unpostable condition, the SB/SE Division must contact the customer to request a copy of the Determination Letter⁸

⁸ A Determination Letter is sent to all organizations that have been approved to receive tax-exempt status.

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issued by the TE/GE Division to determine what type of return the organization should be filing.

The Internal Revenue Manual established specific criteria for a manageable unpostable inventory level. The ending inventory of unpostables should not exceed 10 percent of the cumulative receipts for the last 22 weeks, or the ending inventory should not exceed receipts by 15 percent for 3 consecutive weeks. If this occurs, the IRS considers the inventory unmanageable. For our audit period, we concluded that the unpostable over-age inventory was unmanageable because the over-age inventory of EO unpostables exceeded 15 percent for 12 consecutive weeks.

We could not find any evidence that TE/GE Division CAS analysts formally communicated these increased unpostable inventory levels to SB/SE Division management. In addition, we could not determine whether TE/GE Division CAS analysts performed any type of trend analysis to determine why the inventory levels exceeded acceptable levels or whether any actions were taken to reduce the levels. The TE/GE Division has developed procedures and a report format for the TE/GE Division CAS analysts to capture information on over-age unpostables; however, they have not implemented the guidelines and did not complete the portion of the report format dealing with over-age inventory levels. As a result, TE/GE Division and SB/SE Division management were not formally informed of this unmanageable inventory.

Based on the operational review report format, the monthly operational reviews should include information on the status of the aged inventory. However, our review of 11 operational review reports for the 12-month period between April 2002 and March 2003 found that analysts did not include any remarks regarding whether the unpostable inventory was at acceptable levels. In three of the operational review reports, the TE/GE Division CAS analysts recorded the volume of the unpostable inventory but had no comments that the inventory was at unmanageable levels.

The TE/GE Division needs to formalize its process for documenting and reporting potential processing concerns.

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For example, if unpostable inventories are reaching unmanageable levels that could result in processing delays, analysts need a mechanism to alert, report, and track the condition with SB/SE Division management. The monthly operational review is one method that could be used to track the condition. Analysts could use the Generalized Unpostable Framework (GUF) 55-43 report to identify weekly totals of unpostable inventory by program and by specific unpostable codes. The report also identifies the volume of cases that are over-aged. When we discussed this concern with TE/GE Division management, they advised us that, in the near future, they would formally implement a process of documenting and reporting processing concerns to SB/SE Division management.

Methods to reduce the number of unpostable conditions need to be identified

TE/GE Division CAS analysts should proactively work with other functions (i.e., EP, EO, and GE) in the TE/GE Division to identify the causes or reasons for the high volume of unpostable conditions. By working together, analysts could determine if actions taken by other TE/GE Division staff could assist in reducing or preventing problems that occur during the processing of returns.

Some of the unpostable conditions could be caused by taxpayer errors, such as mistakenly filing the incorrect form or providing information on the return that was inconsistent with prior information sent to the IRS. If taxpayer errors are the predominant reasons, the TE/GE Division may need to consider different outreach and education strategies that could reduce the volume of these unpostable conditions.

However, in other instances, the unpostable conditions may be occurring because the IRS has not appropriately updated information on its computer system. For these conditions, customers have filed all the information timely and on the correct form, but because the IRS' computer system did not contain the correct filing requirements information, the return information could not be entered on the system. We identified one situation in another Treasury Inspector

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General for Tax Administration audit⁹ where this occurred. In this situation, some exempt organizations had their status changed from a public charity to a private foundation. However, their filing requirements had not been updated on the IRS' computer system until we brought it to TE/GE Division management's attention. If this is occurring on other cases and the private foundations correctly file a Form 990-PF the next year, the return information will become an unpostable condition because the IRS' computer system will incorrectly show the filing requirements as a Return of Organization Exempt From Income Tax (Form 990). Jointly, analysts from the different TE/GE Division functions may be in the best position to pinpoint the reason the IRS computer system is not being appropriately updated, which would enable the return information to correctly post in the first place, thereby preventing the unpostable condition.

In these situations, customers may be unnecessarily burdened with correspondence requesting that they submit information to resolve the unpostable condition even though they may have met all the filing requirements.

Recommendations

1. The Commissioner, TE/GE Division, should develop methods to alert the TE/GE Division's CAS function of potential processing problems and should implement a formal process for documenting and reporting unmanageable conditions.

Management's Response: The inventory level is currently being monitored for unmanageable conditions. The unpostable criteria that the TE/GE Division will monitor are set forth in the Internal Revenue Manual.

2. The Director, CAS, TE/GE Division, should work with the three TE/GE Division functions to proactively identify the causes or reasons for the

⁹ *The Tax Exempt and Government Entities Division Could Improve the Efficiency of Its Advance Ruling Follow-Up Process* (Reference Number 2003-10-141, dated August 2003).

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high volume of unpostable conditions. TE/GE Division CAS analysts could use information contained in the GUF 55-43 report to trend unpostable conditions and select samples with the objective of identifying causes for the conditions, which could be used to assist in reducing customer burden and the cost to resolve the unpostable conditions.

Management's Response: The Director, CAS, TE/GE Division, will expand the sharing of the results of operational visit findings with the Directors of EP, EO, and GE. The CAS analysts have started to use the GUF reports to monitor unpostable conditions and inventories.

Detailed Objective, Scope, and Methodology

The objective of the audit was to determine whether the Tax Exempt and Government Entities (TE/GE) Division's Customer Account Services (CAS) function provided adequate oversight to ensure that the Small Business/Self-Employed (SB/SE) Division effectively processed TE/GE Division returns and resolved errors associated with the returns without unnecessarily burdening TE/GE Division customers. To accomplish our objective, we performed the following audit tests:

- I. Determined whether the TE/GE Division CAS function provided sufficient oversight over the SB/SE Division's processing of the TE/GE Division returns.
 - A. Determined whether measures were developed to evaluate the effectiveness of the programs performed by the SB/SE Division.
 - B. Determined whether the TE/GE Division CAS function established a process to capture the information necessary for measuring the effectiveness of the programs.
 - C. Determined whether the TE/GE Division's CAS function and the SB/SE Division at the Ogden Campus¹ have established a process for identifying, tracking, reporting, and resolving processing issues.
 - D. Determined whether TE/GE Division CAS analysts performed any reviews to identify opportunities to improve efficiencies and reduce the burden on customers.
 - 1. Assessed inventory levels that had unpostable conditions and determined whether the SB/SE Division timely issued correspondence to resolve the conditions.
 - 2. Identified unpostable and reject rates of the various TE/GE Division returns and determined whether the TE/GE Division's CAS function took any actions to eliminate or improve these rates.
 - 3. Reviewed 11 operational reviews performed by TE/GE Division CAS analysts from April 2002 to March 2003 to identify processing concerns and determined whether any actions were taken to resolve the issues.

¹ Campuses are the data processing arm of the Internal Revenue Service. The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

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- II. Determined whether the TE/GE Division took any actions to improve the processing of TE/GE Division returns and/or to reduce burden on its customers.
 - A. Conducted research of Internal Revenue Service web pages to identify any processing concerns and determined whether TE/GE Division management has taken any actions to address the concerns.
 - B. Interviewed TE/GE Division management and various staff and determined whether TE/GE Division CAS analysts had performed a trend analysis of the unpostable codes to assess the cause of the unpostables and what is being done to improve these rates.
 - C. Evaluated the resolution codes of unpostable conditions and determined whether there were opportunities to reduce customer burden when resolving these conditions.

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Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Nancy A. Nakamura, Director

James V. Westcott, Audit Manager

John W. Baxter, Senior Auditor

Edward Gorman, Senior Auditor

Carol A. Rowland, Auditor

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Appendix III

Report Distribution List

Commissioner C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Customer Account Services, Tax Exempt and Government Entities Division
SE:T:CAS
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Management Controls OS:CFO:AR:M
Audit Liaison: Director, Communications and Liaison, Tax Exempt and Government Entities
Division SE:T:CL

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Appendix IV

**Tax Exempt and Government Entities Division Returns
Processed at the Ogden Campus¹**

Employee Plans Returns

Form 5330 - Return of Excise Taxes Related to Employee Benefit Plans

Form 5558 - Application for Extension of Time to File Certain Employee Plan Returns

Exempt Organizations Returns

Form 990 - Return of Organization Exempt From Income Tax

Form 990-BL - Information and Initial Excise Tax Return for Black Lung Benefit Trusts and Certain Related Persons

Form 990-EZ - Short Form Return of Organization Exempt From Income Tax

Form 990-PF - Return of Private Foundation

Form 990-T - Exempt Organization Business Income Tax Return

Form 990-W - Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations

Form 1120-POL - U. S. Income Tax Return for Certain Political Organizations

Form 5578 - Annual Certification of Racial Nondiscrimination For Private School Exempt From Federal Income Tax

Form 5768 - Election/Revocation of Election by an Eligible 501(c)(3) Organization To Make Expenditures To Influence Legislation

Form 8868 - Application for Extension of Time To File an Exempt Organization Return

Form 8871 - Political Organization Notice of Section 527 Status

Form 8872 - Political Organization Report of Contributions and Expenditures

¹ Campuses are the data processing arm of the Internal Revenue Service. The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

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Tax-Exempt Bonds Returns

Form 8038 - Information Return for Tax-Exempt Private Activity Bond Issues

Form 8038-G - Information Return for Tax-Exempt Governmental Obligations

Form 8038-GC - Information Return for Small Tax-Exempt Governmental Bond Issues, Leases, and Installment Sales

Form 8038-T - Arbitrage Rebate and Penalty in Lieu of Arbitrage Rebate

Form 8328 - Carry Forward Election of Unused Private Activity Bond Volume CAP

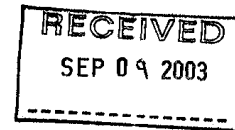
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Appendix V

Management's Response to the Draft Report




DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224



SFP - 9 2003

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM Evelyn A. Petschek, Commissioner
Tax Exempt and Government Entities 

SUBJECT Response to Draft Audit Report – Additional Emphasis Is
Needed to Reduce the Burden for Tax Exempt and Government
Entities Customers During Returns Processing
(Audit No. 200310018)

I was pleased to see that your review shows that TE/GE Customer Account Services provided adequate oversight to ensure that the Small Business/Self-Employed (SB/SE) Division effectively processed TE/GE returns and resolved errors associated with those returns without unnecessarily burdening our customers. Our primary mission is to provide accurate and timely responses to our customers' submissions. We will continue to stress customer service, along with employee satisfaction and business results as we improve our operation.

Although we generally agree with your recommendations, we need to clarify certain items in your report:

1. The footnote on Page 1 states the campuses process paper and electronic submissions. The campuses only process paper. Electronic returns are processed at the computing centers.
2. Page 2 of your report indicates that the Service Level Agreement (SLA) that sets forth the services the SB/SE Division provides for processing TE/GE returns expires on September 30, 2006. The SLA does not have an expiration date.
3. Appendix IV lists Form 8038-Q. This form was declared obsolete in 1998.

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2

We have the following comments in response to your recommendations:

RECOMMENDATION 1

The Commissioner, TE/GE Division, should develop methods to alert the TE/GE Division's CAS function of potential processing problems and should implement a formal process for documenting and reporting unmanageable conditions.

CORRECTIVE ACTION

We are monitoring the inventory level for unmanageable conditions.

The unpostable criteria that we will monitor are as follows:

1. Aged inventory should not exceed 10% of the ending inventory, and
2. If a Submission Processing Center's ending inventory exceeds receipts by 15 percent for 3 consecutive weeks, or aged inventory exceeds 10 percent per week, we will consider the inventory unmanageable.

These criteria are set forth in IRM 3.30.125, BMF/EOMF/EPMF Inventories for Submission Processing Center processing.

CORRECTIVE ACTION MONITORING PLAN

Not applicable. Corrective action has been implemented.

IMPLEMENTATION DATE

Not applicable. Corrective action has been implemented.

RESPONSIBLE OFFICIAL

Not applicable. Corrective action has been implemented.

RECOMMENDATION 2

The Director, CAS, TE/GE Division, should work with the three TE/GE Division functions to proactively identify the causes or reasons for high unpostables conditions. TE/GE Division CAS analysts could use information contained in the GUF 55-43 report to trend unpostables conditions and identify causes for the conditions.

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3

CORRECTIVE ACTION

The Director, CAS, TE/GE Division will expand the sharing of the results of operational visit findings with the directors of Employee Plans, Exempt Organizations, and Government Entities. The CAS analysts have started to use the Generalized Unpostable Framework (GUF) reports to monitor unpostable conditions and inventories.

CORRECTIVE ACTION MONITORING PLAN

Not applicable. Corrective action has been implemented.

IMPLEMENTATION DATE

Not applicable. Corrective action has been implemented.

RESPONSIBLE OFFICIAL

Not applicable. Corrective action has been implemented.

If you have any questions, please contact John Ricketts, Director, TE/GE Customer Account Services at (513) 263-3733.